

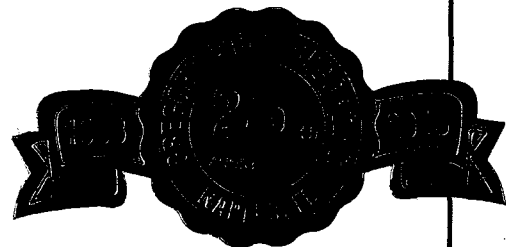
FINANCIAL INDUSTRY REGULATORY AUTHORITY, INC.

JAMES C. EASTMAN, ARBITRATION NO.: 10-04514

Claimant,

v.

MORGAN STANLEY SMITH BARNEY, LLC and MORGAN
STANLEY SMITH BARNEY FA
NOTES HOLDINGS, LLC,
Respondents.



EXCERPT OF TRANSCRIPT OF PROCEEDINGS

TESTIMONY OF JEFFREY A. GELFAND VIA SPEAKER PHONE

ARBITRATORS: CHAIRMAN LANGFRED W. WHITE, ESQ.
THOMAS J. PATKA, ESQ.
HOWARD L. HILL

APPEARANCES:

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Proceedings recorded by digital sound recording.

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CHAIRMAN WHITE: Mr. Gelfand, good afternoon.
My name is Langfred White. I'm the panel chairman
for this arbitration. Thank you for taking the
time to speak with us.

Do you swear or affirm that the testimony you
are about to give will be the truth, the whole
truth and nothing but the truth?

MR. GELFAND: I do.

CHAIRMAN WHITE: State your name, please.

MR. GELFAND: Jeffrey A. Gelfand.

CHAIRMAN WHITE: And what is your business
address, Mr. Gelfand?

MR. GELFAND: 2000 Westchester Avenue,
Purchase, New York 10577.

CHAIRMAN WHITE: Thank you, Mr. Gelfand.

Mr. Vernon, go ahead.

MR. VERNON: Thank you, Mr. Chairman.

DIRECT EXAMINATION

BY MR. VERNON:

Q Good afternoon, Mr. Gelfand. Can you hear me
okay?

A Sure.

Q Is there anybody there with you?

A No, I'm alone.

1 Q All right. Thank you.

2 I represent Mr. Eastman in this dispute, and I
3 don't want to get into what you've discussed with Morgan
4 Stanley lawyers, but I assume they've given you some
5 understanding of what this case is about?

6 A Just some very general background.

7 Q And did you receive something -- a three-ring
8 binder called Claimant's Exhibit Notebook?

9 A I received that this morning.

10 Q All right. And do you have it in front of
11 you?

12 A Yes, I do.

13 Q If you'd open that book, and I just want to
14 cover a little bit of preliminaries so it's easy to
15 follow. Everybody has been working out of these books
16 for a couple of days, but it's new to you.

17 You'll see that it's got tabs 35 through 75.
18 Do you see that?

19 A Yes.

20 Q And just, for example, let's flip over to tab
21 35. Do you see --

22 A Okay.

23 Q Do you see that document? It says Statement
24 of Claim in Arbitration?

25 A Yes.

1 Q And then, at the top right-hand corner, it
2 says Eastman 35, dash, and a bunch of zeroes and a one?

3 A Yep.

4 Q And each of the tabs is set up that way. So
5 if I ask you to turn to page -- or excuse me, tab 37,
6 page 1, you'll understand what I'm talking about,
7 correct?

8 A Yes.

9 Q All right. Thank you.

10 Let's flip over to -- I'm going to cover a
11 couple of tabs in the back and then move -- and then get
12 back closer to the front and work through it. I am not
13 going to cover all these tabs, obviously, but let's
14 start with tab 58.

15 A Five-eight?

16 Q Yes, sir.

17 A Okay.

18 Q And you see that document at the top, it says
19 Securities Exchange Commission?

20 A Yes.

21 Q Annual audited report, form X-17A5?

22 A Yep.

23 Q Is that sometimes called a Focus Report?

24 A Right.

25 Q And this is a report, a Focus Report for the

1 year 2011?

2 A Okay.

3 Q Do you see that?

4 A Yes.

5 Q And it's for a broker/dealer, correct?

6 A This is for a broker/dealer, yes.

7 Q And that's the Morgan Stanley Smith Barney
8 broker/dealer?

9 A Yes.

10 Q And I'll represent to you they are a party in
11 this action.

12 And who's the contact person as of 2011?

13 A Myself.

14 Q And that's in the middle of the page?

15 A Yes.

16 Q On the left-hand side?

17 A Right.

18 Q And what is your title -- well, let me ask it
19 this way.

20 If you recall, what was your title in 2009 at
21 the -- what we're calling MSSB, which is the
22 broker/dealer?

23 A My title then, which is the same now as it
24 relates to MSSB, would be CFO, chief financial officer.

25 Q And what's the current name of the firm?

1 A The current name of the broker/dealer is still
2 Morgan Stanley Smith Barney, LLC.

3 Q I thought there was a change. Was there a
4 change to Morgan Stanley Wealth Management, or something
5 like that?

6 A That is a marketing name, you know, a brand
7 name as opposed to a legal entity name. The
8 broker/dealer name is still Morgan Stanley Smith Barney.

9 Q Fair enough.

10 So the brand name, you dropped Smith Barney?

11 A That's right.

12 Q All right. If you flip back to tab 56, I want
13 to ask you a few questions about the other entity in
14 this case.

15 A Okay.

16 Q We've covered the broker/dealer. This is --
17 I'll represent to you this is a document we got from the
18 public records of the state of Delaware regarding, I
19 believe, Morgan Stanley Smith Barney FA Notes Holdings,
20 LLC.

21 Do you see that document, tab 56?

22 A Yes.

23 Q And what we've typically been calling this
24 entity in this arbitration is FA Notes or FA Notes
25 Holdings. I just want to let you know that in case I

1 call it that.

2 A Okay.

3 Q And if you recall -- well, I'll tell you, and
4 I'll ask you if this is correct.

5 Isn't it correct that Morgan Stanley Smith
6 Barney joint venture came about on or around the summer
7 of 2009?

8 A It would be -- summer of 2008 -- it would be
9 June 1st or May 31st. I think it's June 1st, depending
10 on how you view the calendar. That's -- that's the
11 spring, but --

12 Q So, my question is, it appears, from this
13 record, this state record, that Morgan Stanley -- or FA
14 Notes Holdings was created approximately 12, 13 days
15 prior to the joint venture?

16 A Right, in anticipation of the formation of the
17 joint venture, yes.

18 Q So, really, this is -- will you answer my
19 question, this entity really didn't exist but for in
20 anticipation of the joint venture?

21 A That's correct.

22 Q And what does this entity do today?

23 A This entity is essentially a service entity
24 that services the broker/dealer, and holds all the notes
25 issued to FA either pre (indiscernible) before the

1 formation of the joint venture or notes that were issued
2 subsequent to the formation of the joint venture.

3 Q And so they --

4 A (Indiscernible) set up essentially because
5 having the notes in a separate entity is more efficient
6 from a capital and financing point of view. So it's
7 basically a service entity.

8 Q All right. And you said that they are holding
9 the notes. Do they have physical possession of the
10 original notes?

11 A A physical presence --

12 Q I'm sorry. I think you misheard my question
13 or I misspoke.

14 What I was saying, you said it's -- you said
15 -- I think you said FA Notes Holdings is holding the
16 notes. It's a servicing corporation that holds the
17 notes.

18 My question is does FA Notes Holdings have
19 physical possession of these notes.

20 A You know, I -- I don't really believe that FA
21 Notes Holding has a physical location. I'm not sure
22 that they do have physical -- when I said holding, I
23 meant they carry them on their books and records and are
24 the legal owner. Where the notes physically reside, I
25 -- that, you need to talk to our attorneys. I'm not

1 really sure where the notes actually physically reside.

2 Q All right. And then you said, from a capital
3 and financing point of view, that this was a better
4 structure for Morgan Stanley, correct?

5 A It's just a little bit more efficient for us.
6 It's how we operated as Morgan Stanley prior to the
7 joint venture. I think Citi may or may not have
8 operated that way. I believe they did not.

9 Q And would it be fair to say that, on the FA
10 Notes Holdings books, these would be considered accounts
11 receivables?

12 A That's fair.

13 Q And these would not be carried on the books of
14 Morgan Stanley Smith Barney, the broker/dealer, correct?

15 A That's correct.

16 Q And why is it more efficient from a capital or
17 financing point of view, if you would explain that to
18 the panel.

19 A From -- having notes in the broker -- notes,
20 as a broker/dealer, or receivables, especially to
21 employees, are a hundred percent capital charge item.
22 And so having them away from the broker/dealer just
23 allows us to minimize the regulatory capital associated
24 with them and operate the broker/dealer more
25 efficiently.

1 And it also allows us to downstream funding
2 for the notes more efficiently into the broker/dealer
3 from MSSB Holdings than going through the broker/dealer,
4 which involves a, from a regulatory point of view, a
5 capital infusion, and a lockup -- not a lockup, isn't
6 the right word, but it basically requires a minimum
7 capital requirement.

8 It just gives us more efficiency. It's more
9 efficient for us to move capital -- cash in and out of
10 the entity than it is into a broker/dealer.

11 Q Okay. I have to be honest with you. I did
12 not follow all of that. I think that you explained it
13 pretty well, and if I was a CPA, I probably would have
14 understood all of it. But I did pick up on a couple of
15 things.

16 I think the first thing you said, something
17 about a hundred percent capital charge?

18 A If they reside at a broker/dealer, yes.

19 Q And so you don't have to worry about the
20 accounts receivable or these notes impacting the hundred
21 percent capital charge of the broker/dealer because
22 they're housed outside of the broker/dealer?

23 A That's correct.

24 Q And if you can explain to the panel and me
25 what -- how -- explain the hundred percent capital

1 charge. What are you saying?

2 A That there's a minimum capital -- a regulatory
3 capital requirement for a broker/dealer, and that's
4 calculated based on a couple different ways, but one way
5 -- one of the calculations involves, basically, reducing
6 your assets by -- any asset by certain things that are
7 -- have a hundred percent capital charge, and then
8 calculating what your net available capital is vers --
9 and then we'll get that versus your ratio and by holding
10 them outside the broker/dealer, you don't have that
11 unnecessary charge.

12 Q Okay. I think I understand. Is this -- let
13 me see if I can articulate and ask you if it's fair to
14 say this.

15 Is it fair to say that if the accounts
16 receivable of these promissory notes were held inside
17 the broker/dealer, your net capital requirements would
18 be higher?

19 A Yeah, I guess it would. It would depend on
20 whether we're above minimums and stuff like that and how
21 much the actual required net would -- could be higher,
22 in most cases would likely be higher if they're held in
23 the broker/dealer.

24 Q Well, whether it would or wouldn't, and a
25 hundred percent of the time, what I'm trying to get at

1 is the point or the purpose of doing this is to avoid
2 increasing your net capital requirement.

3 Is that fair to say?

4 A Increase the capital requirement. I don't
5 believe there -- the reason I was hesitating is I don't
6 believe it would necessarily increase the capital
7 because we finally broke (sic) a deal well in excess of
8 the minimum capital required.

9 Q All right. I appreciate your responses. I
10 think they are good responses, but I'm not following.
11 I'm trying to follow.

12 What advantage, and you may have already said
13 this, but what advantage does the broker/dealer get by
14 not housing the notes within the broker/dealer?

15 A There's two advantages. One is, as we said,
16 that it does reduce the required capital. That doesn't
17 necessarily impact how much capital we actually have,
18 but it does reduce the requirement if that was important
19 at any point in time. And it also increases our
20 flexibility of funding the notes.

21 Q So there's a potential benefit to the
22 broker/dealer in that it reduces the required capital,
23 correct?

24 A Correct.

25 Q And you said increases our flexibility of

1 funding the notes.

2 Who are you referring to when you said our?

3 A MSSBH.

4 Q And that would be Morgan Stanley Smith Barney
5 Holdings?

6 A Yes.

7 Q Which is not a broker/dealer.

8 A Not a broker/dealer. It's the parent of the
9 broker/dealer and of Notes Holdings.

10 Q And how would it increase the flexibility of
11 funding notes?

12 A It just allows us to move cash in and out of
13 the -- for needs of the notes without -- sometimes it
14 can be a regulatory requirement or a regulatory approval
15 or notification on moving cash in and out of the
16 broker/dealer. It avoids that and just allows us to do
17 funding on a -- how we do the funding to be a little bit
18 different by being away from a broker/dealer.

19 Q So there were regula -- the regulators you're
20 talking about are the regulators that would regulate the
21 broker/dealer?

22 A That's correct.

23 Q So the --

24 A It basically takes it out of a regulated
25 entity into -- out of a regulated entity and holds them

1 in a non-regulated entity.

2 Q So that, again, would be a benefit to the
3 broker/dealer?

4 A Yeah. Small benefit, but yes.

5 Q Is there any other reason that you can think
6 of and tell the panel why this was done, other than to
7 reduce the required capital and increase flexibility, of
8 funding the broker/dealer for regulatory purposes?

9 A Those would be the only reasons.

10 Q And to your knowledge, is FA Notes Holdings a
11 broker/dealer, a member of FINRA?

12 A It is not a broker/dealer, to my knowledge.

13 Q And I may have already asked you this, but do
14 you have a title at FA Notes Holdings?

15 A I believe my title at FA Notes Holdings is
16 also CFO.

17 Q And do you think that was the case back in
18 2009?

19 A Yes.

20 Q Does the FA Notes Holdings serve any other
21 purpose other than holding the notes?

22 A I believe that's the only activity in FA Notes
23 Holdings.

24 Q And as CFO, can you tell the panel roughly how
25 much they're holding in notes? Ballpark.

1 A I think, with retention notes and everything,
2 it's probably somewhere in the ballpark of 3 to \$4
3 billion.

4 Q Do you know, roughly, how much they originally
5 held when they were created, just after the joint
6 venture?

7 A It was probably somewhere around one or two.
8 The retention notes were about two and a half billion
9 dollars that added to that in January of 2010.

10 So, it probably was somewhere in the range of
11 1 to 2 billion at day one.

12 Q All right. Thank you.

13 Let me now go back to tab 41.

14 A Okay.

15 Q And if you go to page 10 within that tab.

16 A Okay.

17 Q Now, this is a difficult document to read, and
18 I -- it's the copy I have to work with, so I'm hopeful
19 you'll be able to see it. I just have a couple of
20 questions.

21 One, at the top of the page, if you can read
22 the first sentence or read whatever you want to read,
23 but I'll direct you to the first sentence. And above
24 the first sentence, if you can tell me who the parties
25 are to this agreement.

1 A It appears to be Salomon Smith Barney, Inc.
2 and James Eastman.

3 Q Thank you. And if you'd look at the bottom,
4 can you tell when you -- when it looks like it was
5 created?

6 A It looks like May 18, 2001.

7 Q And then if you'd flip over to page 13,
8 there's another promissory note there, and if you'd do
9 the same with that, I think you have to look at the
10 second sentence to see who one of the parties is, and if
11 you look in the box above that, you'll see who the other
12 party is. If you'd just tell us who the parties are.

13 A It looks like it's CitiGroup Holdings --
14 CitiGroup Global Markets Holdings, CGMI.

15 Q And then Mr. Eastman at the top?

16 A Mr. Eastman at the top.

17 Q And then if you look at the bottom of that
18 first paragraph numbered one, the next to the last
19 sentence, do you see it says that it was created on or
20 about March 13, 2009?

21 A Yes.

22 Q So one of the notes was 2001, one's March of
23 2009.

24 And then if you flip over, I'm going to --
25 still in the same tab, flip over to page 17.

1 A All right.

2 Q Can you tell the panel what that document is?

3 A It looks like the formation agreement of
4 Morgan Stanley Smith Barney Holdings, the joint venture.

5 Q And let me make a statement and you tell me
6 whether it's just -- it's maybe an oversimplification,
7 but generally accurate.

8 CitiGroup took some of its assets and Morgan
9 Stanley took some of its assets, and they put them
10 together in this entity called Morgan Stanley Smith
11 Barney Holdings, LLC?

12 A That's correct.

13 Q And I think -- I'm not sure the exact word you
14 used, but a little while ago, I think you referenced
15 MSSB Holdings as maybe the parent company?

16 A It's the parent of the joint venture between
17 Citi -- CitiGroup and Morgan Stanley, yes.

18 Q But all -- but the assets at the beginning --
19 I know there's multiple transactions here, but at the
20 beginning, the assets actually went to MSSB Holdings,
21 correct?

22 A Both of the parents contributed to Morgan
23 Stanley Smith Barney Holdings. I believe everything
24 flowed through Morgan Stanley Smith Barney Holdings.

25 Q Fair enough. And this is dated May 29, 2009.

1 A Okay.

2 Q And that was after the promissory notes we
3 just covered just 30, 40 seconds ago?

4 A That's correct.

5 Q And if you'd look at the next few pages, pages
6 -- we're on page 17. And look from page 17 through page
7 21.

8 A Okay.

9 Q And this appears to be pages 8, 9, 10, 11 of
10 the agreement.

11 Do you know why the signature line wasn't
12 provided in this arbitration?

13 A I have no knowledge.

14 MS. GERBER: Objection.

15 BY MR. VERNON:

16 Q Do you know why the entire agreement was not
17 presented?

18 MS. GERBER: Objection.

19 CHAIRMAN WHITE: Hold on.

20 MR. GELFAND: Again, I have no knowledge of --

21 CHAIRMAN WHITE: Hold on, Mr. Gelfand.

22 MS. GERBER: One second, Mr. Gelfand.

23 CHAIRMAN WHITE: There's an objection before
24 the panel.

25 MS. GERBER: That is not correct. The entire

1 agreement was produced in this arbitration, and I
2 have it at Bates numbers 42063 through 42238. And
3 I have copies of it here.

4 MR. VERNON: I believe you if you say that.

5 UNIDENTIFIED MALE VOICE: What were the
6 numbers again, please?

7 MS. GERBER: (Indiscernible) here.

8 CHAIRMAN WHITE: Then I sustain the objection.

9 MR. VERNON: Yeah, and I'll withdraw it.

10 CHAIRMAN WHITE: And go ahead.

11 MR. VERNON: Yeah, I was not aware of that.

12 MS. GERBER: Okay.

13 MR. VERNON: All right. Could you -- could
14 you hand me that document if you got copies?

15 MS. GERBER: I have copies of it, yes, I do.
16 And I believe that Mr. Gelfand has copies of it in
17 front of him, too.

18 MR. VERNON: Okay.

19 MS. GERBER: This is for the panel.

20 CHAIRMAN WHITE: Are these for us or --

21 MS. GERBER: They're for you.

22 (Indiscernible).

23 ARBITRATOR PATKA: Wait a minute. Are these
24 -- this is tab -- what did you say this tab was?

25 MS. GERBER: Well, this one --

1 MR. VERNON: Well, there's -- there's a --

2 ARBITRATOR PATKA: They're the same as tab --
3 you just said.

4 MS. GERBER: It's the complete version.

5 ARBITRATOR PATKA: Right. And what -- what
6 tab was that?

7 MR. VERNON: It would -- it's tab -- in my
8 book, it's tab 41, pages 17 through 21.

9 ARBITRATOR PATKA: Is this the same as forty
10 -- I'm just saying I don't need this if it's
11 already in here.

12 MS. GERBER: Well, what we try to do is just
13 take the applicable pages and insert it as an
14 exhibit to our -- the motion that you have in tab
15 41, which was in opposition, because of that
16 document. We -- rather than attach the entirety of
17 the document, we attached only what we thought were
18 the relevant pages, but --

19 MR. VERNON: And I -- and it's completely my
20 fault, but I wasn't aware they produced that entire
21 document. So I haven't had a chance to review it.
22 Again my fault. I don't know whether I'm going to
23 cover it at all.

24 Mr. Patka, I think you can just set it aside
25 and --

1 ARBITRATOR PATKA: That's what I was going to
2 do.

3 MR. VERNON: Yeah.

4 CHAIRMAN WHITE: I have a procedural question.
5 Is this being offered by anybody as an exhibit yet?

6 MR. VERNON: No.

7 UNIDENTIFIED MALE VOICE: Good question.

8 MS. GERBER: No, but I think that, during
9 Mr. Kelly's (phonetic) testimony, we will be
10 offering it as an exhibit because I think there
11 were some questions raised previously as
12 (indiscernible).

13 CHAIRMAN WHITE: Okay. Then, Ms. Gerber, my
14 next question is, if nobody is offering it as an
15 exhibit yet, should we give it back and wait for
16 you to turn around and give it back to us or should
17 we just hold it?

18 MR. VERNON: I don't mind if you just hold it.

19 CHAIRMAN WHITE: All right.

20 MR. VERNON: I --

21 CHAIRMAN WHITE: Sorry, Mr. Gelfand. Some
22 procedural stuff.

23 Go ahead, Mr. Vernon.

24 BY MR. VERNON:

25 Q All right, Mr. Gelfand. I just reviewed this

1 document quickly to see if you signed it, and it looks
2 like it was signed by James Goreman (phonetic) instead
3 of you.

4 Who's Mr. Goreman?

5 A Mr. Goreman is currently the CEO of Morgan
6 Stanley.

7 Q Is he -- he's your boss?

8 A He's my boss' boss' boss.

9 Q Okay. Fair enough. All right.

10 Now, let's say -- let's don't try to get into
11 the full agreement, even though you have a copy. Let me
12 -- I actually may not need to cover anything here. I
13 think I've covered the main point regarding accounts
14 receivable.

15 Let me flip over. We're going to stay in the
16 same tab. Let me go to page 23 in that tab.

17 UNIDENTIFIED MALE VOICE: And it's tab 41?

18 MR. VERNON: Yes, sir, tab 41, page 23.

19 MR. GELFAND: Okay.

20 BY MR. VERNON:

21 Q And this appears to be a contribution
22 assignment and assumption agreement. And I'll tell you,
23 I've seen -- I've seen two of these agreements, and I'm
24 going to try to cover both of them with you.

25 And this agreement appears to be an agreement

1 between CitiGroup Global Markets Holdings and Morgan
2 Stanley Smith Barney Holdings, LLC; is that correct?

3 A Yes.

4 Q And it looks like Citi is giving -- or maybe
5 not giving -- is selling or contributing, assigning or
6 -- or assigning something to Morgan Stanley Smith Barney
7 Holdings, which we called the parent corporation,
8 correct?

9 A That's correct.

10 Q And neither of these parties, either of these
11 holdings companies are FINRA members, to your knowledge,
12 are they?

13 A To my knowledge, no. You mean CitiGroup
14 Global Markets Holdings or Morgan Stanley Smith Barney
15 Holdings?

16 Q Yes, sir.

17 A Neither one is, to my knowledge. I'm not a
18 hundred percent sure on the Citi side, not being from
19 Citi, but I would suspect not. I can definitely tell
20 you that Morgan Stanley Smith Barney Holdings is not.

21 Q Okay. And then if you'd flip over to the next
22 page, page 24, section 2.1, it appears that something is
23 being contributed and it's listed -- or the
24 contributors, I think, are listed in schedule A of this
25 document.

1 A Okay.

2 Q And if I flip back to page 30, I see schedule
3 A.

4 A Okay.

5 Q Do you see that? And I've looked at that, and
6 you may correct me, but I'm just thinking that -- and,
7 really, this -- it's the point of this, I want to be
8 corrected if I'm wrong, but I don't think any of these
9 subsidiaries that are contributing were any of the
10 subsidiaries that were holding the notes of that
11 broker/dealer or the holding company.

12 A Again, not being familiar with CitiGroup's
13 structure and how they held things before the joint
14 venture, I can't say that for a fact.

15 Q Okay.

16 A But suspect, looking at the list, that that's
17 likely true, but I don't know.

18 Q Okay. And then if you go back to page 28, you
19 signed this document?

20 A I believe so. Yes.

21 Q All right. And let's go to what I think is
22 the contribution, assignment and assumption agreement
23 really at issue in this case, and that is at page -- tab
24 45.

25 A Okay.

1 Q Page 11, it starts. And you had mentioned
2 that the joint venture had occurred on or about May 31st
3 or June 1st, 2009.

4 A Yes. I think the thirty -- yeah, it's
5 somewhere in that May 29th, June 1st -- different things
6 moved at different times, but within that time frame,
7 yes.

8 Q Right. And the date on here is May 31st,
9 2009.

10 A Okay.

11 Q Okay. And I'll represent to you this, I
12 believe, is a different contribution agreement than we
13 just covered, but I think this is the one that covers
14 the promissory notes that we were talking about that's
15 being housed in a servicing organization known as FA
16 Notes Holdings and that 1 to 2 billion transferred over.

17 And if you could, take a look at this. Just
18 -- you can just look at the first paragraph for now, if
19 you want to, and tell the panel who the parties were
20 that were involved in this transaction.

21 A It would be Morgan Stanley Smith Barney
22 Holdings; Morgan Stanley Smith Barney, LLC, which is the
23 broker/dealer; Morgan Stanley Smith Barney Financing,
24 which is another service company to the broker/dealer;
25 Morgan Stanley Smith Barney FA Notes, which is the other

1 company we've talked about that holds notes.

2 Q And then they're all given acronyms or short
3 names in this agreement. The parent company, MSSB
4 Holdings, is called the contributor, correct?

5 A Yes.

6 Q And the broker/dealer is called the same thing
7 we're calling it in this arbitration, MSSB, correct?

8 A Yes.

9 Q And what we're calling FA Notes Holdings in
10 this arbitration is actually, in this agreement, called
11 NoteCo (phonetic).

12 A Okay. Yes.

13 Q And if you'd look, it appears to be that --
14 well, I'll just ask you.

15 Did the -- in your -- for your understand ---
16 from your understanding, did the promissory notes first
17 go into MSSB Holdings from Citi and from Morgan Stanley
18 before it ended up in FA Notes Holdings?

19 A Yes. That would be my understanding.

20 Q And if you'd look at -- so I think this is the
21 document that where the mothership, if you will, or the
22 parent corporation, MSSB Holdings, is deciding where
23 these notes will go within the other organizations that
24 signed this agreement, correct?

25 A Correct.

1 Q And if you look at section 2.1 entitled
2 Contribution, Assignment and Assumption of Liabilities,
3 I know it's small print, but if you could just read that
4 to the panel.

5 A Contribution on the terms and subject to the
6 conditions set forth in this agreement, contributor
7 hereby contributes, assigns, transfers, conveys and
8 delivers to each recipient, and each recipient hereby
9 accepts all the contributor's right, title and interest
10 in, to, and under the assets listed or described under
11 such recipient's name on schedule 1A attached hereto,
12 together (indiscernible) the MSSB Holdings contributed
13 assets, but excluding all assets listed or described
14 under such recipient's name on schedule 1B attached
15 hereto, free and clear of all liens, other than
16 permitted liens and liens created pursuant to the
17 transaction document, the contribution.

18 Q Okay. And we may come back to this, but let's
19 flip over to schedule 1A, which is on page 16.

20 A Okay.

21 Q And this would be where all MSSB Holdings'
22 right, title and interest in, to and under the assets
23 listed in schedule A are going. And at the top, you've
24 got MSSB, and that refers to the broker/dealer, correct?

25 A That's correct.

1 Q And at the bottom, you've got NoteCo, which
2 refers to FA Notes Holdings?

3 A Correct.

4 Q And if you could just read to the panel what
5 it says under NoteCo.

6 A Assets such that the assets of NoteCo are as
7 reflected in the balance sheet attached hereto under the
8 heading MSSB, FA Notes Holding, LLC, end quote,
9 including, without limitation, all legacy Citicorp (sic)
10 Group broker/FA Notes.

11 Q And if you could just explain to the panel
12 your understanding of legacy CitiGroup broker/FA Notes.

13 A Those would be FA notes that were -- those
14 would be notes issued to FAs prior to the formation of
15 the joint venture that were still in operation related
16 to the FAs contributing to the joint venture.

17 Q And if you look up under the MSSB, the
18 broker/dealer section, does it indicate anything in
19 there about any interest to, under, from, any interest
20 whatsoever going to -- of the legacy CitiGroup broker/FA
21 Notes going to MSSB, the broker/dealer?

22 A There's no indication of that here.

23 Q All right. Let's flip back.

24 A It refers to a balance sheet. I don't know.
25 Is the balance sheet attached? Presuming there's no

1 balance -- assets show in that balance sheet.

2 Q Yes, there is, I think, a balance sheet
3 attached, but it is very difficult to read. It is on
4 page 20, twenty -- pages 20, 21 and maybe 22. I can't
5 tell whether that's part of it. It looks like there's a
6 note on page 22. And I have difficulty reading it, but
7 I'm sure you're more familiar with this than I am.

8 Did you want a minute to look at that, or
9 would you like me to continue?

10 A (Indiscernible) I -- if there's any captions
11 here that would include FA Notes.

12 I don't see anything on this balance sheet
13 that would indicate that there were FA Notes in the
14 balance sheet attached.

15 Q Okay. So, based on what you've reviewed, all
16 of title, interest in, to and under the assets under
17 those -- of those legacy FA Notes went to FA Notes
18 Holdings, lited as NoteCo, correct?

19 A That's correct.

20 Q And none went to MSSB, the broker/dealer?

21 A That's correct.

22 Q And if you turn back to page 14, a couple of
23 pages back.

24 A Yep.

25 Q And, again, this is a document signed by the

1 holding company correct?

2 A Yep.

3 Q And you signed on behalf of the holding
4 company?

5 A I signed on behalf of the holding company, as
6 well as the broker/dealer, Notes Holding and Financing.

7 Q So, MSSB broker/dealer actually signed this
8 document?

9 A That's correct.

10 Q So they were a party to this document?

11 A That's correct.

12 Q If the promissory notes went into the holding
13 company, MSSB Holdings, according to this agreement, and
14 then went directly to FA Notes Holdings or NoteCo, is it
15 fair to say that Morgan Stanley Smith Barney, the
16 broker/dealer, never owned or held these notes?

17 A Morgan Stanley Smith Barney, the
18 broker/dealer, would never have held these notes, that's
19 correct.

20 MR. VERNON: All right. Thank you, Mr.
21 Gelfand. What I'm going to do now, with the
22 permission of the panel, is take a short break,
23 probably be two or three minutes, and with the
24 chairman's permission, and just check with my team.
25 I think I'm about done. I appreciate your time. I

1 may have a couple more questions, but I just want
2 to check, and I'll be back in a minute.

3 MR. GELFAND: Okay.

4 CHAIRMAN WHITE: Okay. Mr. Gelfand, just stay
5 on the line. Don't go anywhere.

6 MR. GELFAND: No problem.

7 MS. GERBER: We'll put you on mute. How about
8 that?

9 CHAIRMAN WHITE: We probably won't talk. The
10 recorder will be going.

11 MS. GERBER: Oh, he's going to
12 (indiscernible).

13 MR. VERNON: I'll know in a second.

14 MS. GERBER: Oh, great. That would be great.

15 MR. VERNON: Is that --

16 CHAIRMAN WHITE: That would be even better.

17 MS. GERBER: That probably would.

18 MR. VERNON: We'll be right back.

19 MS. GERBER: Thank you.

20 (Pause in proceedings.)

21 MR. VERNON: Mr. Chairman, I have no further
22 questions of this witness.

23 CHAIRMAN WHITE: Thank you. Ms. Gerber?

24 CROSS-EXAMINATION

25 BY MS. GERBER:

1 Q Hi, Mr. Gelfand. Thanks for being with us
2 today. I do have a few questions for you.

3 I think that we've established already that
4 MSSB, the broker/dealer, is not the holder of the notes,
5 but I want to ask you some other questions --

6 A Sure.

7 Q -- about MSSB's, the broker/dealer's
8 relationship to these notes.

9 Does MSSB benefit in any way from these notes
10 that are held by FA Notes Holdings?

11 A Yes.

12 Q Can you please explain to the panel how the
13 broker/dealer benefits from the notes held by FA Notes
14 Holdings?

15 A In a couple -- at first, due to the
16 arrangements between FA Notes Holdings and MSSB, the
17 broker/dealer, that basically the economic interest in
18 the notes transfers back, financially back into MSSB so
19 that if, you know, there's a default or a loss on the
20 notes, that MSSB has the notes, has the -- bears the
21 financial loss related to the notes, and the economics
22 of the spreads and -- on -- earned on the notes between
23 the cost of funds and the interest on the notes actually
24 accrues back to MSSB, too, through earnings
25 (indiscernible) between the service company, NoteCo, as

1 the service company, and MSSB, but even more
2 importantly, the notes are given to FAs as part of their
3 employment and to retain them and to -- as employees of
4 MSSB, and so the productivity of the FAs are tied to
5 having -- or having the notes, and therefore, you know,
6 MSSB is really the beneficiary of the work and labor of
7 the FAs in the broker/dealer that's associated with the
8 notes being in place.

9 Q Mr. Gelfand, are you familiar with -- I guess,
10 some of these notes provide for a forgivable component.
11 I'm probably not saying that in an accounting
12 appropriate way, but taking Mr. Eastman's first note
13 that Mr. Vernon asked you about, did you see that that
14 note provides for -- it's called a forgivable loan?

15 A Right.

16 Q Okay. And the second note, is that note also,
17 in essence, forgiven over time?

18 A Yeah. I think, given the difference in the
19 timing, and I think the first was in 2001, and the
20 second one was in 2009, I think the most common
21 structure, going back, had been a forgivable note, where
22 the loan was granted up front, and, over time, a portion
23 of it was forgiven.

24 More recently, in -- probably as reflected in
25 the 2009, there's a stand-alone note and then there's a

1 bonus agreement between the broker/dealer or the entity,
2 and the FA that mirrors the terms and obligations of the
3 note so that the note is granted up front, giving cash
4 to the FA, and over the period of time that the payments
5 are due to the FA -- from the FA to pay down the note,
6 there is a bonus that the FA receives that, by and
7 large, matches off -- there's a little bit of interest
8 differential that -- on the rates because of IRS rates
9 and things like that, that create a little bit of
10 breakage, but by and large, there's a bonus or -- a
11 bonus that is paid to the FA for the exclusive purpose
12 of paying down the note that matches the note term.

13 Q And Mr. Gelfand, are you aware of who pays
14 that bonus, what entity?

15 A The bonus would be paid by MSSB.

16 Q The broker/dealer?

17 A The broker/dealer, yes.

18 MS. GERBER: I don't have any further
19 questions for you, Mr. Gelfand, but the panel may.
20 So don't hang up yet.

21 CHAIRMAN WHITE: Redirect?

22 MR. VERNON: Thank you, Mr. Chairman.

23 REDIRECT EXAMINATION

24 BY MR. VERNON:

25 Q Mr. Gelfand, it's Chris Vernon again. I'm

1 representing Mr. Eastman. I do have a couple of
2 follow-up questions based on those questions.

3 When Ms. Gerber asked you about the benefit to
4 Morgan Stanley, broker/dealer, we had already -- you and
5 I had already talked about a couple of benefits that
6 they get. And then you mentioned -- the first thing you
7 mentioned was another benefit to the broker/dealer, and
8 that is an economic interest goes back into MSSB. I
9 think that's what you said.

10 And I'll go further and I'll tell you what I
11 think you meant, and that is if there is a promissory
12 note that goes unpaid, becomes a bad debt, does MSSB,
13 broker/dealer, get the benefit of that as well?

14 A If there's a -- if there's a promissory note
15 that goes unpaid, the economics of that go back to MSSB,
16 the broker/dealer. I'm not sure that's a benefit.
17 That's a loss, but --

18 Q Right. It reduces the profits, it reduces the
19 taxability?

20 A Right.

21 Q Which is a benefit.

22 A Well, it reduces -- a loss isn't a benefit.
23 The tax is, I guess, a benefit.

24 Q From a tax standpoint, right?

25 A Right. There's a tax loss, yes.

1 Q Tax -- they get the tax loss.

2 A Yes.

3 Q All right. And then --

4 A Although I just -- not to complicate things,
5 but both entities that we're talking are limited
6 liability corporations and don't pay income taxes. So
7 that benefit passes up through the parents of the owners
8 of the JV.

9 Q And which entity is a public entity, which
10 Morgan Stanley entity is a public entity?

11 A None of the ones we're talking about.

12 Q Which one is? There is one, right?

13 A There's a Morgan Stanley and I think it's --
14 Morgan Stanley is the name of the public entity.

15 Q And what relation does it have to the entities
16 we're talking about?

17 A Morgan Stanley through -- indirectly owns 51
18 percent, at the time we're talking about, owned 51
19 percent of the -- of Morgan Stanley Smith Barney
20 Holdings. It currently owns 65 percent.

21 Q With an agreement to buy a hundred percent, if
22 they want?

23 A There's an agreement to -- in place to step up
24 over time, which was amended last fall, that gives us a
25 little bit different flexibility on the Morgan Stanley

1 side to increase their ownership subject to approval by
2 the regulators.

3 Q So they were -- over time, they were sort of
4 buying out Citi; is that a fair statement?

5 A The original deal was structured as a step-up
6 transaction, yeah.

7 Q And then the -- I want to follow up on one
8 more thing Morgan Stanley's counsel asked you about, and
9 that was about, I guess, the bonuses in the later years,
10 the bonuses to the financial advisors and I'm not sure
11 it's covered in this one, but is what you're saying is
12 that the financial advisor writes a check to FA Notes
13 Holdings or sends a check to FA Notes Holdings; is that
14 correct?

15 A I believe that is.

16 Q Okay. So, in order to get the bonus, the
17 financial advisor writes a check and he sends it --

18 A Mr. Vernon, I'm not a hundred percent whether
19 they actually write a check or it's netted in their
20 compensation. I believe they do write a check, but I
21 may be confused with some of the other places I've
22 worked. I'm not a hundred percent sure of what the
23 mechanics are as far as whether the broker writes the
24 check or he or she receives a net payment.

25 Q But it goes to FA Notes Holdings, correct?

1 A It goes to FA Notes Holdings, that's right.

2 Q Regardless of whether it's a check or a net?

3 A That's correct.

4 Q And then the broker/dealer gives a W-2 to the
5 broker reflecting a bonus payment net of taxes, correct?

6 A That's correct.

7 MR. VERNON: I don't have any further
8 questions.

9 CHAIRMAN WHITE: Mr. Patka, do you have any
10 questions of Mr. Gelfand?

11 ARBITRATOR PATKA: Yes, I have. I have one,
12 just a point of clarification.

13 Mr. Gelfand, we have a situation in which the
14 notes are not paid and, under the agreement,
15 ostensibly, then become due and payable, correct?

16 MR. GELFAND: Yes.

17 ARBITRATOR PATKA: Okay. And you've
18 explained, in some questions from Ms. Gerber, what,
19 to me, sort of as an amateur, sound, in essence,
20 like what I would call sort of third-party
21 benefits, meaning that if the money gets paid back,
22 it goes to the broker/dealer, and not to holdings
23 and several other things that you said.

24 In, again, in kind of lay language, what, if
25 anything, among those benefits, gives Morgan -- the

1 broker/dealer the right to call in these notes, the
2 legal right to call in these notes?

3 MR. GELFAND: Does the broker/dealer have the
4 legal right to call the note? I believe that the
5 notes -- there's actions on the notes based on the
6 behavior of the -- of the FA that allowed the notes
7 to be terminated or -- on Morgan Stanley's side.

8 I believe that if the individual continues to
9 be employed and is compliance free, that I believe
10 that -- and you'd have to check with the attorneys
11 -- I don't believe that we have rights to just
12 arbitrarily call the notes. I think there's cause
13 reasons why we'd call the note.

14 But the notes terminate upon termination of
15 employment at MSSB and are due at that point.

16 Does that answer the question? I'm not really
17 sure I understand the question.

18 ARBITRATOR PATKA: What I'm trying to -- I
19 guess what I'm trying to understand is that I
20 believe I heard Ms. Gerber say that they have
21 conceded that the broker/dealer does not -- is not
22 the holder of the notes, and it hadn't become
23 entirely clear to everybody, but I guess one of the
24 arguments that's going to go on here is does that
25 mean that because they don't hold the notes, that

1 perhaps we should dismiss them from one of these
2 actions.

3 And she asked you a series of questions that,
4 again, sound to me like trying to establish the
5 fact that the broker/dealer has some kind of, if
6 nothing else, you'd call them a third-party
7 interest to these notes, and what I'm trying to
8 understand, I guess from a layman's point of view,
9 is that what, if anything, about those third-party
10 interests would allow the broker/dealer to call in
11 notes that they have conceded that they don't have
12 any, I guess, legal right to, or that they don't --
13 they don't hold them.

14 Do you understand my question?

15 MR. GELFAND: But I think that the trigger in
16 the notes relates to employment, which -- and the
17 employment is between the broker/dealer and the
18 broker. So I think that the -- not to say that the
19 broker/dealer can terminate somebody capriciously,
20 but they do have that card as far as terminating
21 the note is related to terminating the -- or either
22 -- to terminating the FA or the broker.

23 Other than that, I don't believe -- I don't
24 believe, under the terms of the notes, that there
25 is any ability to, except for termination or for

1 some other cause or infraction, (indiscernible) the
2 broker/dealer from a performance or -- point of
3 view that the notes can be terminated.

4 ARBITRATOR PATKA: Okay. Yeah, that pretty
5 much answers my question. Thank you.

6 MR. GELFAND: Thank you.

7 CHAIRMAN WHITE: Mr. Hill? Any questions from
8 Mr. Hill?

9 ARBITRATOR HILL: Well, I don't understand
10 what you mean, terminated. What does that mean?
11 Does it have something to do with the notes or the
12 broker?

13 MR. GELFAND: (Indiscernible).

14 CHAIRMAN WHITE: Did you understand the
15 question, Mr. Gelfand?

16 MR. GELFAND: I'm saying, by termination, I
17 mean that they are -- they're no longer an employee
18 of MSSB.

19 ARBITRATOR HILL: Well, I understand what that
20 is, but you said the notes being terminated, and
21 that --

22 MR. GELFAND: The note would then become due
23 at the time that the employee is no longer employed
24 at MSSB, is what I meant by termination of the
25 note. So it becomes -- the notes are generally

1 nine-year notes. On some of the older ones, maybe
2 shorter. Some of the newer ones could be a little
3 bit longer.

4 But they are -- they basically stay in force
5 for the whole time as long as the FA or broker is
6 an employee of MSSB. Should that relationship, the
7 broker's relationship with MSSB terminate in any
8 way, the note becomes due and payable.

9 ARBITRATOR HILL: Well, I understand that, but
10 I'm having a little trouble understanding having a
11 note assigned to some other company, FAA (sic)
12 Holdings, in its entirety. I'm having a little
13 trouble understanding entirety. I mean, that it --
14 I don't know how they -- I did have a little
15 problem with how it could be assigned, as I think
16 the verbiage said, but yet that -- there are
17 reservations about -- about it being in its
18 entirety and being -- everything being assigned.

19 It's entire -- it's -- I understand what we're
20 saying here, I just don't understand how that
21 legally is separated, I guess. Maybe the attorneys
22 can explain that a little bit better.

23 CHAIRMAN WHITE: Yeah. Mr. -- I don't mean to
24 cut you off.

25 ARBITRATOR HILL: It's okay.

1 CHAIRMAN WHITE: Mr. Gelfand, this is
2 Mr. White.

3 I think I -- I think I understand Mr. Hill's
4 concern. Let's -- let's try this.

5 Take a look at tab 25 -- I'm sorry, tab 45,
6 page 11, please. And the second heading, 2.1. Are
7 you there?

8 MR. GELFAND: Yes.

9 CHAIRMAN WHITE: All right. Now, I want to be
10 sure that I understood what you said before.

11 Is this the document by which ownership of the
12 future -- the financial advisor notes for
13 Citi/Smith Barney employees passed to Note
14 Holdings?

15 MR. GELFAND: Yes.

16 CHAIRMAN WHITE: All right. In section 2.1,
17 the language that Mr. Vernon asked you to read
18 says, in part, that it conveys all the
19 contributor's right, title and interest, and that
20 language is typically used in an absolute
21 assignment.

22 The relationship, the business relationship
23 you described a few minutes ago, where the risk of
24 loss and the economic -- the risk of economic gain
25 flows back to MSSB sounds to me an awful lot like

1 an assignment for collection and not an absolute
2 assignment.

3 And in the case of an assignment for
4 collection, the holder would have the right to
5 enforce the note, but wouldn't necessarily be the
6 beneficial owner. Is that your under -- first of
7 all, do you understand the difference between an
8 absolute assignment and an assignment for
9 collection?

10 MR. GELFAND: Yeah, I'm not -- I'm not an
11 attorney, but I think I generally understand what
12 you're saying.

13 CHAIRMAN WHITE: Okay. What kind of an
14 assignment is this? That's probably not a fair
15 question.

16 MR. GELFAND: Yeah, I'm not really sure. I
17 mean, I think that's a legal technical
18 (indiscernible).

19 CHAIRMAN WHITE: Yes, sir. Let me object to
20 my own question, sustain the objection and try
21 again.

22 MR. GELFAND: But this is a contribution from
23 MSSB to NoteCo in section 2.1, not to MSSB to
24 NoteCo (sic), right?

25 CHAIRMAN WHITE: What we're looking at here is

1 an assignment from Holdings as the contributor to a
2 group of entities, including NoteCo.

3 MR. GELFAND: Including NoteCo, right.

4 CHAIRMAN WHITE: I think you testified that
5 you came from the Morgan Stanley side; is that
6 correct?

7 MR. GELFAND: That's correct.

8 CHAIRMAN WHITE: So you wouldn't necessarily
9 have personal knowledge of the Smith Barney side as
10 far as the way these notes were handled.

11 In the -- in the 2009 time frame, as the joint
12 venture was being considered, and was in the
13 process of being put into play, if the
14 broker/dealer, in this case, Smith Barney, advanced
15 a future advance -- made a future advance loan to
16 either a new broker -- a new financial advisor
17 coming on board, or a retention bonus to an
18 existing financial advisor, who paid that money?
19 Was it the broker/dealer? Did the money come from
20 somewhere upstream? Did the money come from Note
21 Holdings?

22 MR. GELFAND: It did not come from Note
23 Holdings. I'm not -- on the Smith Barney side, I'm
24 not sure where that would have come from, on which
25 entity it was actually funding on the Smith Barney

1 -- on the CitiGroup side before they were actually
2 contributed to Holdings. If such case existed on
3 the Morgan Stanley side, Morgan Stanley's other
4 broker/dealer, where the FAs were employed at that
5 time, which would be Morgan Stanley and Co., would
6 have funded that note and then contributed it down
7 to MSSB Holdings in May, but prior to May, you
8 know, prior to -- prior to the closing of the joint
9 venture agreement, there would have -- each entity
10 would have continued to operate the way they had
11 operated and how they had funded up until that
12 point.

13 CHAIRMAN WHITE: Okay. Now, let's --

14 MR. GELFAND: (Indiscernible) all these
15 entities, Holdings, NoteCo, were all, you know,
16 established in the weeks before the closing, you
17 know, in order to get an entity that was, you know,
18 separated from the two parents, given the joint
19 venture nature of the agreement.

20 CHAIRMAN WHITE: Okay. Let's move forward in
21 time and say that Note Holdings holds a note
22 receivable, a forgivable loan from a financial
23 advisor. And let's further assume that the
24 financial advisor leaves the employment of the
25 broker/dealer. And let us further assume that the

1 financial advisor pays that note, simply pays the
2 note balance.

3 The money would be paid to the holder, which
4 is Note Holdings, and where does the money go from
5 there? Does it stay in Note Holdings? Does it go
6 out to --

7 MR. GELFAND: The actual cash to pay down?
8 Yes, it would stay in Note Holdings.

9 CHAIRMAN WHITE: Say that last again, please.

10 MR. GELFAND: The cash to pay down the note
11 would stay in Note Holdings.

12 CHAIRMAN WHITE: Would stay in Note Holdings.

13 MR. GELFAND: Right.

14 CHAIRMAN WHITE: When the note is assigned to
15 Note Holdings to begin with from the broker/dealer,
16 how is that handled from an accounting standpoint?

17 MR. GELFAND: I'm sorry. When it's assigned
18 to Note Holdings from the broker/dealer?

19 CHAIRMAN WHITE: Yes, sir.

20 MR. GELFAND: I don't think there's -- except
21 for day one, there was no assignment, and the
22 assignment didn't come from the broker/dealer. It
23 came from Holdings.

24 CHAIRMAN WHITE: What is the current practice
25 if a -- if a signing bonus -- sorry -- if a

1 forgivable loan is made to a financial advisor to
2 either stay or come on board, who's that note --
3 and a note would be issued, who is the note -- to
4 whom is the note issued? Is it to the
5 broker/dealer or is it issued to Note Holdings?

6 MR. GELFAND: If someone -- if a new note is
7 issued, it would be issued by Note Holdings. I
8 think, later in the week, or at some other point,
9 you're talking to my controller, Mike Kelly. He
10 will be much more familiar with the mechanics of
11 how this actually flows than I am, but Note
12 Holdings would issue the note to the FA. I believe
13 it's an agreement that also MSSB is a party to,
14 because of the bonus aspect of it, but I'm not
15 exactly sure how that's structured.

16 But the note and cash actually goes from Note
17 Holdings to the broker, day one.

18 CHAIRMAN WHITE: All right. Then one last
19 question to try and help me understand, and that
20 is, you testified earlier that if the note is not
21 paid, then that loss flows downstream to the
22 broker/dealer. And, in essence, the broker/dealer
23 has to, if you will, has to pay Note Holdings.

24 MR. GELFAND: I believe that's right, that
25 there's a P and L -- there's an arrangement where

1 there -- the P and L, as opposed to the balance
2 sheet aspects of the note, there's an arrangement
3 between the broker/dealer and Note Holdings that
4 the economics, on a P and L basis, flow between FA
5 Notes and to MSSB.

6 CHAIRMAN WHITE: Okay. Then you had earlier
7 indicated that benefits, at least I had understood
8 you to say that benefits and losses flow
9 downstream, but now I understand, I think a little
10 better, that if the note is paid, the cash stays in
11 Note Holdings. If it's not paid, the loss flows
12 downstream to the broker/dealer.

13 What benefit, if any, flows downstream to the
14 broker/dealer?

15 MR. GELFAND: What benefits flows to -- there
16 is the difference between the funding cost of the
17 notes at Note Holdings, and what the actual
18 interest rate is on the notes, that those
19 economics, which actually may not be favorable,
20 float back to the broker/dealer, and I think, as I
21 said to -- before also is the fact that the notes
22 act as a retention device for the -- or recruiting
23 device for the broker/dealer. The broker/dealer is
24 the beneficiary of having that FA as an employee,
25 which is cemented by the -- by the note.

1 CHAIRMAN WHITE: Okay. Thank you,
2 Mr. Gelfand.

3 Based on the panel's questions, Mr. Vernon,
4 any further questions for Mr. Gelfand?

5 MR. VERNON: I think I might have a couple.

6 FURTHER REDIRECT EXAMINATION

7 BY MR. VERNON:

8 Q Mr. Gelfand, it's Chris Vernon again for
9 Mr. Eastman.

10 Is it your understanding that Citi or any
11 City-related entity, when they entered into this joint
12 venture and contributed, assigned the notes over to the
13 new joint venture, did they retain any third-party
14 interest in the notes?

15 A Not to my knowledge, except as an owner of the
16 joint venture. So, to the extent that they owed 49
17 percent, now 35 percent of MSSB Holdings, they had no
18 direct -- no direct benefit or liability related to it.
19 As an owner of the -- you know, part owner or member of
20 the joint venture agreement, they had some residual
21 interest from a bottom line point of view.

22 Q And it's your understanding that they didn't
23 have any right because they transferred all interest to
24 Morgan Stanley Smith Barney Holdings, correct?

25 A That's correct.

1 Q And so then Morgan Stanley Smith Barney
2 Holdings transferred all of its interest to FA Notes
3 Holdings?

4 A Related to notes, that's correct.

5 Q And I think Mr. White was asking about a
6 current practice.

7 Is there a current practice of -- let me
8 withdraw that.

9 Let me ask it this way. I showed you those
10 two promissory notes that are actually at issue in this
11 case.

12 Were those incorporated into the employment
13 agreement or were they stand-alone documents?

14 A I actually don't know the answer to that. I'm
15 not sure if they're part of the employment agreement or
16 they're stand-alone documents. I just don't know.

17 MR. VERNON: That's all I have, Mr. Chairman.

18 CHAIRMAN WHITE: Based on the panel's
19 questions, Ms. Gerber, do you have any further
20 questions of this witness?

21 MS. GERBER: I do not. Thank you.

22 CHAIRMAN WHITE: Tom, do you have any?

23 ARBITRATOR PATKA: No.

24 CHAIRMAN WHITE: Howard?

25 ARBITRATOR HILL: No, no.

1 CHAIRMAN WHITE: Mr. Gelfand, thank you for
2 testifying.

3 (End of requested excerpt.)
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1 STATE OF FLORIDA

2 COUNTY OF COLLIER

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4 I, Joyce B. Howell, do hereby certify that:

5 1. The foregoing pages numbered 1 through 52
6 contain a full, true and correct transcript of
7 proceedings in the above-entitled matter, transcribed
8 by me to the best of my knowledge and ability from the
9 digital recording.

10 2. I am not counsel for, related to, or
11 employed by any of the parties in the above-entitled
12 cause.

13 3. I am not financially or otherwise
14 interested in the outcome of this case.

15

16 SIGNED AND CERTIFIED:

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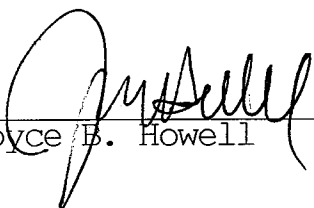
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Joyce B. Howell

Date: April 8, 2013